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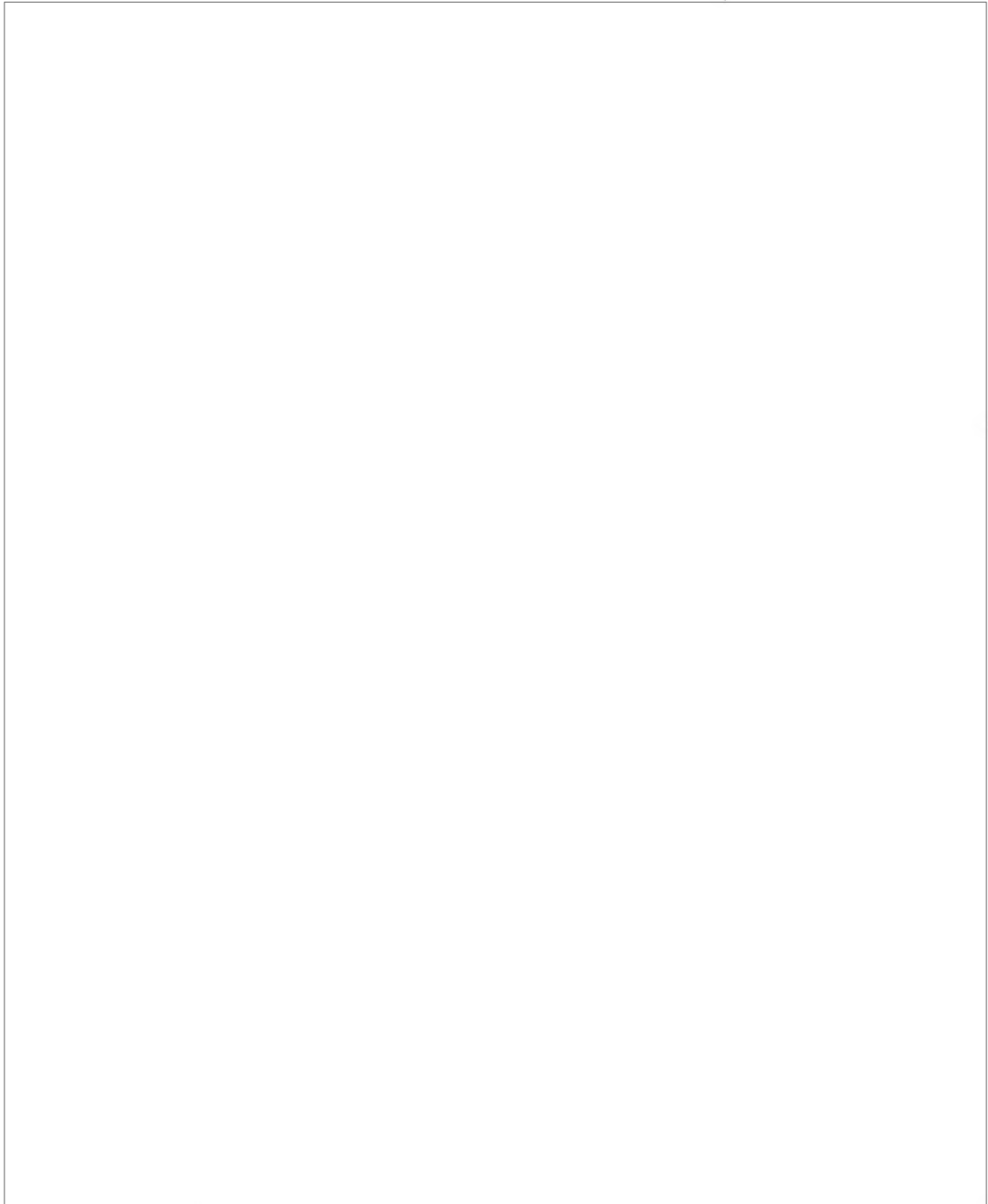
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Sampling the Debate

KGB Chairman Kryuchkov and Deputy Premier Abalkin disagreed over economic policy:

- Kryuchkov: "It would be a ruinous mistake to throw the country into the arms of the elemental forces of the market. . . ."
- Abalkin: [There is no other choice than the market economy] "if we want to end the shame of queues, fill our shops, get out of the crisis. . . . We haven't built socialism and we haven't been living in conditions of socialism."

Ligachev and Yakovlev, while on opposite sides of the Soviet political spectrum, both drew strong applause for their pointed comments:

- Yakovlev: "Let us remember that not only empty shelves, but also empty souls brought about *perestroyka* and demanded revolutionary changes."
- Ligachev, defending his role in the controversial antialcohol campaign, claimed that, while the campaign deserves criticism, it is not a closed chapter, for "drunkenness and alcoholism are . . . a slow Chernobyl for the whole country."

Shevardnadze attacked past military overspending: "If we continue in the way it was done before, comrades, spending one quarter of our budget on military expenditure," [we will ruin our country] . . . and "we will have no need for any army for a ruined country and a poverty-stricken people."

Regional leaders such as Ukrainian First Secretary Gurenko and Leningrad party boss Gidaspov showed their concern with the loss of party prestige and ethnic unrest:

- Gurenko stressed the danger of underestimating anti-Communism and criticized the "absence of even a hint of countering its increasing onslaught."
 - Gidaspov proposed extending presidential power to the regional level by posting presidential representatives around the country and giving them authority to "stave off impending chaos."
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USSR:

Conflict Begins To Emerge at Party Congress

Deep divisions in the party were evident yesterday at the CPSU Congress, despite efforts by Politburo members to minimize confrontation and rally around perestroika.

In speeches Tuesday, party leaders played down personal differences and defended their stewardship of the party over the past five years. Foreign Minister Shevardnadze passionately defended Soviet foreign policy, waving off criticism that Gorbachev's policies have jeopardized national security. In a speech roundly applauded, party secretary Ligachev professed support for *perestroika* but intimated that Gorbachev had inspired the media campaign that has branded Ligachev an enemy of reform. Speakers from both the reform and traditionalist camps yesterday called for Gorbachev to remain party chief, although Azerbaijan party boss Mutalibov, while paying tribute to Gorbachev for starting *perestroika*, blasted the policy for causing bloodshed and, to loud applause, called for a firmer hand.

Gorbachev announced that Politburo members Vorotnikov and Slyun'kov, candidate member Biryukova, and party secretary Usmanov have asked to resign. Shevardnadze and party secretary Yakovlev hinted they too will leave the leadership.

Traditionalist speakers and themes have received the most enthusiastic receptions thus far. The delegates renamed the Congress commission on transition to a market economy the commission on economic reform. The Ukraine's hardline party chief won applause yesterday when he attacked Yakovlev and party secretary Medvedev by name for weakening the party ideologically. The delegates derided Moscow's reformist party boss when he criticized the traditionalist tone of the recent Russian party congress; they applauded wildly when another speaker extolled developments there.

Comment: Reformers and traditionalists generally have decided not to challenge Gorbachev as party chief, fearing a party split and aware that other candidates would be too divisive; some, however, are demanding more decisiveness from him. The traditionalist delegates appear to be spoiling for a fight, although they have not yet tested their strength on a key issue. To avoid a conflict, Gorbachev may already have decided to move some of his allies, such as Shevardnadze and Yakovlev, out of the Politburo.

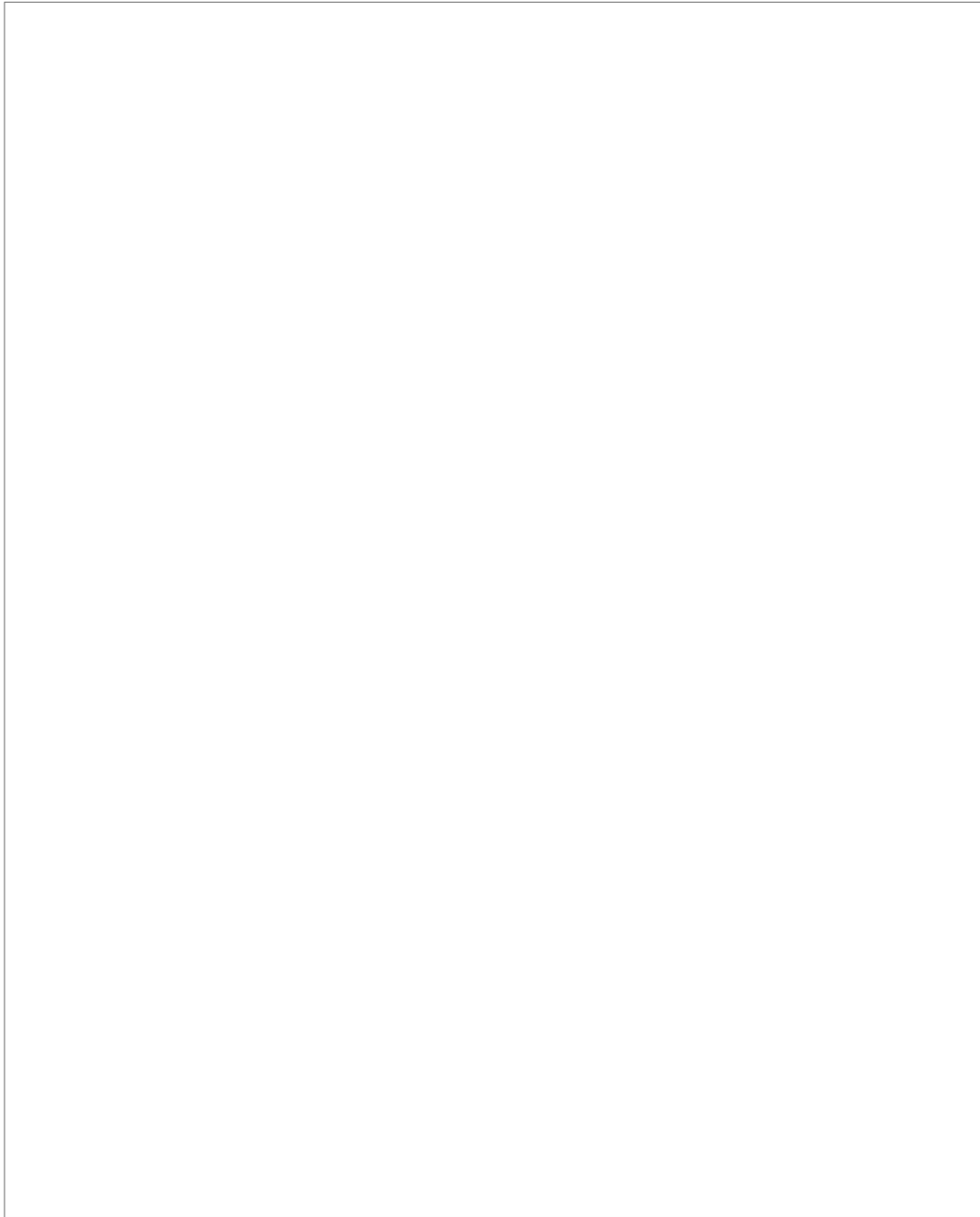
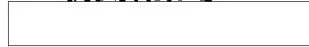
Sweeping changes in the leadership are likely and, given the caution on reform evident in the Congress, Gorbachev will be hard pressed to fill the vacancies with his supporters. If the new Politburo includes members without national stature, its role will be further weakened.

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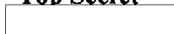
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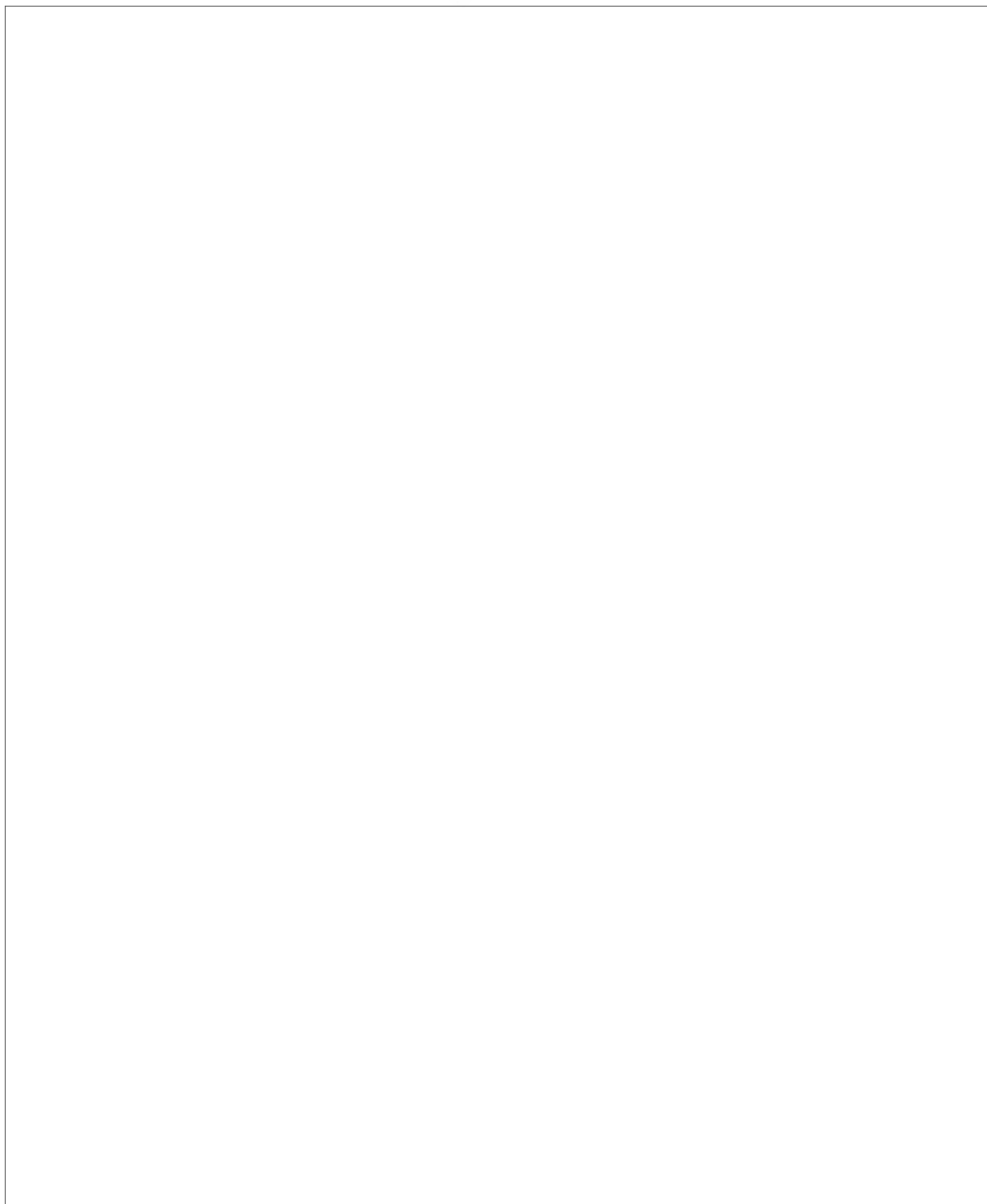
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German Political Unity Likely This Year

Late Monday, one day after the German economic and monetary union went into force, leaders of Prime Minister de Maiziere's five-party East German coalition agreed to Chancellor Kohl's proposal for an all-German election in December. The coalition also agreed on 14 October as the date for elections in newly reconstituted East German states. The coalition decision probably will be approved soon by the five parliamentary caucuses, and an exact date in December is likely to be worked out with Kohl.

State Secretary Krause announced the coalition has not yet reached agreement on the timing of East German accession to West Germany via Article 23 of Bonn's Basic Law. Accession now seems likely either shortly before or after the all-German election. Accord may be reached quickly in talks set to start tomorrow on a treaty on the modalities of political unification, adding to pressure for achieving a two-plus-four agreement by fall.

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GERMANYS:

Off to Good Start

German economic and monetary union is progressing smoothly thus far, but restructuring the East German economy must be carefully managed to avoid increasing social discontent.

The currency conversion that began Sunday has gone virtually without a hitch, and East Germans have not gone on a consumption binge. They are grumbling about sharp price increases for such staples as bread and milk, and isolated strikes to protest low wages, high prices, and rising unemployment have broken out.

West German leaders continue to insist they will rely on private investment to bail out East Germany and will not need to raise taxes or increase planned borrowing. Finance Minister Waigel is urging East and West German officials to limit spending. Senior West German labor leaders are also cooperating; the head of the largest and most powerful union recently said he sees no need for wages in eastern Germany to match western levels by mid-decade.

Comment: The real work of restructuring the East German economy is just beginning and will be painful and complicated. East German industrial production already lags last year's by 5.5 percent; unemployment has jumped 50 percent since last month and is likely to continue increasing sharply for the next few months. At least scattered protests or strikes are likely, and there is an outside chance of more serious disorders.

German leaders must also face a range of thorny practical issues quickly or see progress slacken. West Germans generally oppose letting West German firms accrue monopolistic power in the east, for instance, while East Germans have few qualms because they have no recent experience with competitive markets. Raising such issues, however, risks leading some large West German firms to invest more cautiously in eastern Germany. A key test may be an attempt by three West German utilities to gain a controlling stake in East Germany's electricity industry; they are prepared to invest billions in the East. Bonn probably will let the firms go ahead because the most likely alternative would be public investment in the undercapitalized East German firms.

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ALBANIA:

Odds of More Trouble High

Tirane is hinting of political reforms and taking a conciliatory approach in talks with European embassies harboring some 200 asylum seekers; it clearly wants to limit damage to relations with Western governments resulting from brutal police attempts late Monday to stop the flight into the embassies.

The Albanian Government has offered passports to all refugees seeking asylum in the embassies—26 in the Turkish Embassy have been evacuated from the capital, but others have not yet accepted the offer. Western press reports quote Albanian sources who claim Tirane is prepared to issue an additional 15,000 passports, 13,000 by the end of this week. The Chinese, Cuban, and Egyptian Embassies, meanwhile, have turned over to Albanian authorities those seeking asylum at their locations.

There are also hints of political reform. Tirane will allow the formation of non-Communist parties and multicandidate legislative elections in January, according to the secretary of the Albanian Academy of Sciences yesterday.

Nevertheless, tensions in Tirane remain high. A homemade bomb exploded in the Cuban Embassy compound Tuesday. Despite a heavy police presence, there were more demonstrations yesterday.

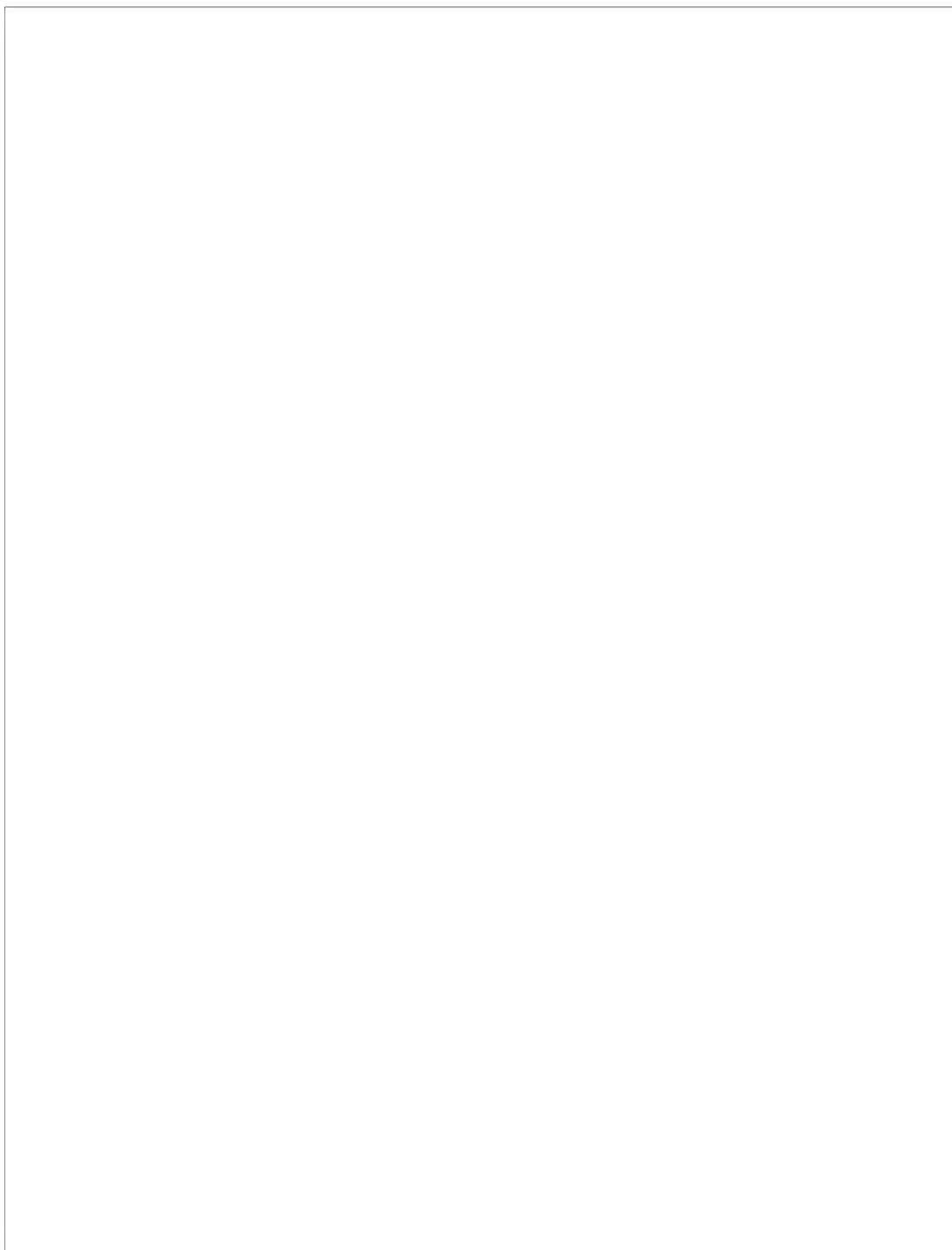
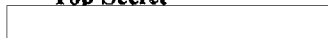
Comment: Continued heavyhanded police measures to prevent further unrest may indicate that regime promises of liberalization are primarily a ploy. Now that the population has begun to strike out against the government and it has responded with concessions, controlling popular demands for change will be extremely difficult.

There is a high potential for spontaneous violence; Albanian culture has a history of resolving conflict through violence, and many grievances have accumulated over decades of total repression. The negotiations with the embassies and talk of reforms indicate that moderates led by Alia are in control of the government. Divisions in the leadership over reform as the price of an opening to the West could intensify quickly, however.

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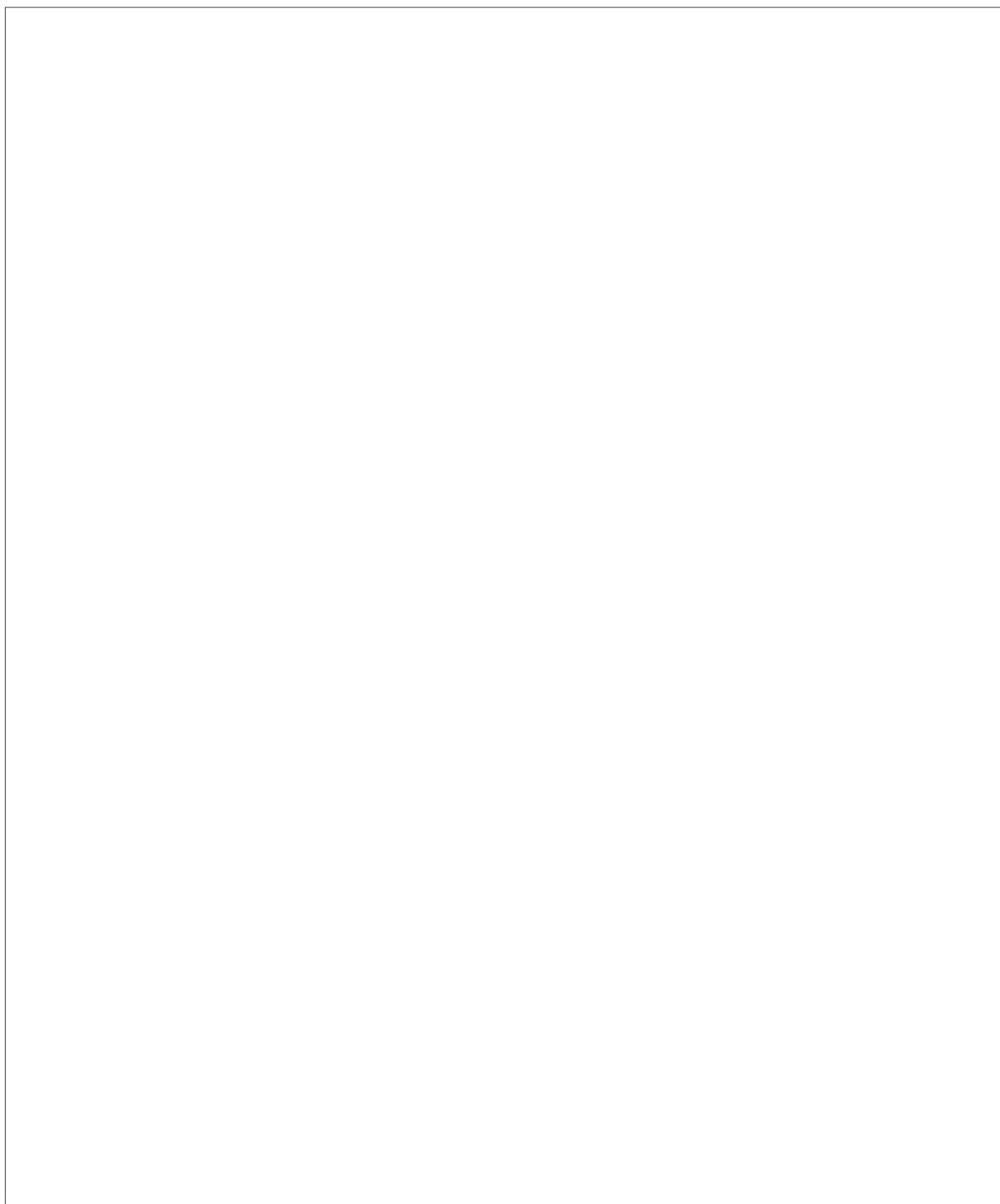
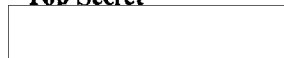
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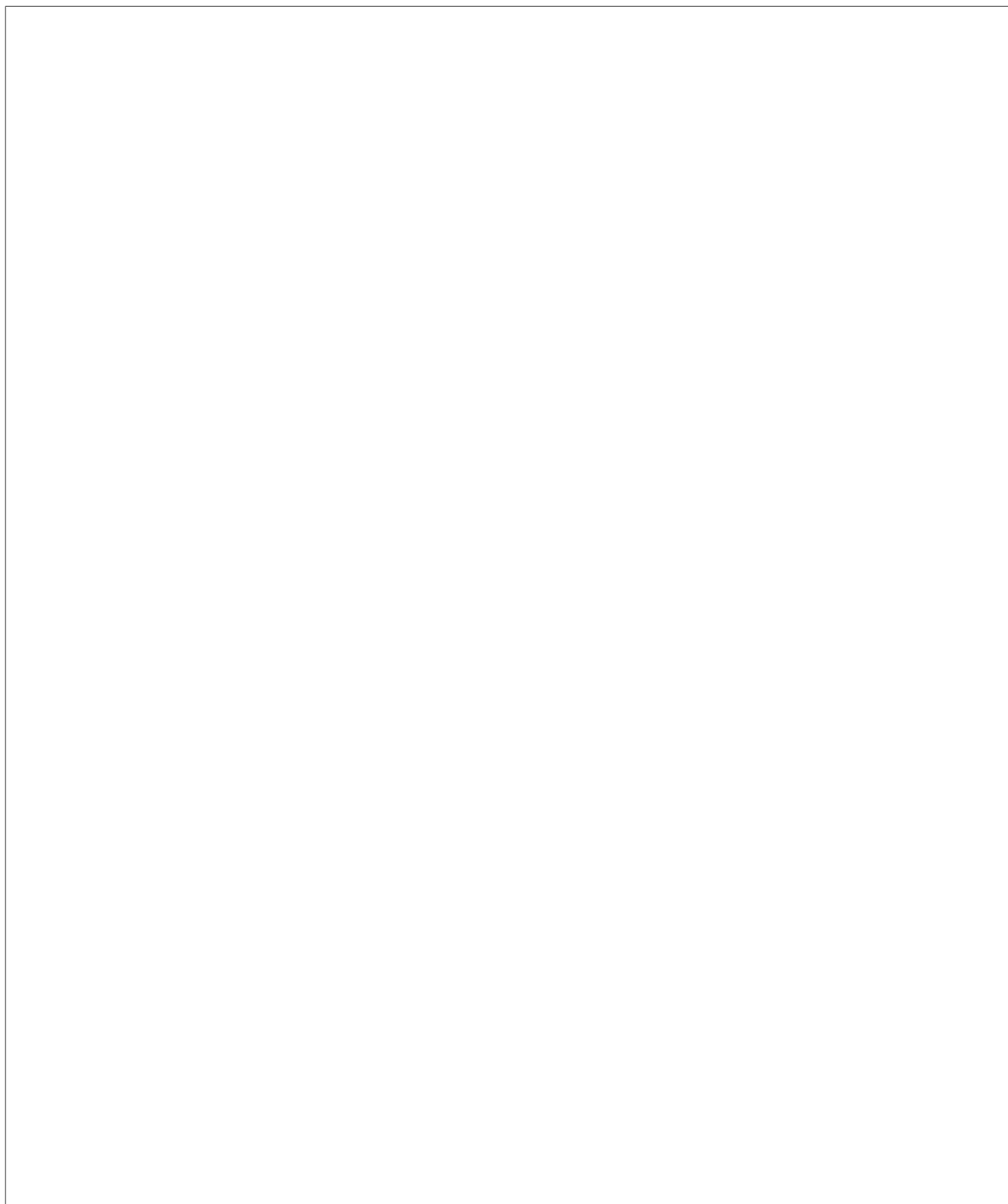
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More To Come From Seoul?

South Korean officials have been discussing a host of proposals to advance the North-South dialogue. Seoul is now looking to build its momentum, and some journalists speculate President Roh may unveil a new proposal, possibly as early as Saturday. Roh might:

Propose a joint disarmament commission. Late last month, the government authorized formation of an interagency group to coordinate Seoul's position on arms control and reduction, according to press reports. Last week, senior diplomats in Seoul and Defense Minister Lee underscored the need to discuss arms reductions with the North, which has proposed a halt to qualitative arms improvements.

Scale back South Korea-US military exercises. The Defense Minister strongly hinted late last month that Seoul might further scale down its annual joint military exercise with the US to ease tensions on the peninsula. P'yongyang has often brought North-South talks to a halt to protest the three-month exercise.

Announce confidence-building measures. The Prime Minister has convened representatives from the Unification Board, the Foreign Ministry, and the military to draw up suggested confidence-building measures. Press reports say these might include prior notification and observation of military exercises, demilitarization of the "demilitarized zone," and establishment of a military hot line, which P'yongyang proposed recently.

Present a nonaggression pact. The Unification Minister last week announced that Seoul is drafting a nonaggression pact in preparation for progress in the North-South dialogue. He said it would address renouncing the use of force as well as mutual recognition of current borders.

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KOREAS:

Prime Ministers May Talk

Hard bargaining lies ahead, although the tentative agreement to hold talks between their Prime Ministers indicates new flexibility in both Koreas.

Building on progress made before the dialogue was cut off five months ago, the two Koreas have set 26 July as the target date for signing an agreement that would lead to talks at the prime-ministerial level as early as next month. The timetable was set after Seoul accepted P'yongyang's proposal to discuss reducing political and military tensions before addressing cultural and economic exchanges.

Comment: Both sides have been under pressure to show movement in their dialogue. The North may see resuming talks now as a way to meet a longstanding US condition for improving ties. The dialogue would also help an increasingly isolated North Korea improve its international image. P'yongyang may also be responding to pressure from Moscow.

German unification has raised interest in the South and is pushing Seoul back to the table. Extensive press coverage of German progress is also fueling opposition calls for movement in the dialogue. The Roh-Gorbachev summit too has raised public expectations for detente with the North, and President Roh clearly sees a political imperative to make progress now.

A meeting between Prime Ministers would be unprecedented but only a first step down a road that promises protracted hard bargaining. North Korea is certain to insist on including in the talks its latest disarmament proposal, which has several points unacceptable to the South. South Korea's military and other conservatives will want to weigh thoroughly the security implications of any concession Seoul's negotiators might offer.

Even a first meeting this summer is not assured. P'yongyang has nixed talks at the last minute in the past, seeking to blame Seoul after having raised expectations in the South.

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HUNGARY: Emergency Economic Program

The Antall government has unveiled a six-month emergency program intended to hold down its ballooning budget deficit. The program calls for price increases of 20 to 45 percent on energy and a variety of consumer goods and cuts on state subsidies for industry. Bankruptcy proceedings will be initiated against the 30 to 40 most indebted firms, and 30 state enterprises will be privatized by the end of this year. To cushion the impact of higher prices, the government will propose a social welfare package designed to increase minimum pension and welfare payments.

Comment: The proposed price increase and subsidy cuts are a direct response to IMF concerns that the state is losing control over its spending. Hungarian officials admit that, without prompt action, the deficit could rise to triple the target specified in the IMF standby agreement. Nevertheless, Antall will have a tough time selling the package. Opponents have criticized it and probably will argue that the price increases are not worth the ensuing popular dissatisfaction. Some 2,000 coal miners have already gone on strike for pay raises of up to 50 percent.

CHINA: Anticrime Drive in Full Swing

The *Daily* of 3 July erroneously reported the recent staging of public executions in China. The note should read, "According to press reports, at least five cities have *staged public trials and carried out executions so far*. During a crackdown in 1983, authorities reportedly executed as many as 10,000 criminals. *Publicizing executions and harsh sentences* will probably serve to intimidate urban workers and migrant laborers from the countryside, whom the regime fears as sources of instability."

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In Brief

- Moscow city soviet trying to increase local autonomy . . . adopted plan to privatize city's trade, consumer services, housing, gradually introduce market prices . . . coupon system would provide basic consumer goods at USSR state prices.
- Uzbekistan legislature has barred USSR Supreme Soviet deputy, told to report on military conscription issues, from participation in legislative session . . . action contravenes Soviet law, underscores republic's declaration of sovereignty last month.

East Asia

- China, Indonesia have announced they will resume diplomatic relations on 8 August . . . Premier Li Peng plans to visit Jakarta . . . Singapore also likely to establish ties to Beijing, possibly by yearend

Americas

- Peruvian President-elect Fujimori in Japan this week seeking aid . . . Tokyo offering only grants, technological assistance . . . like other donors, awaiting resolution of IMF and bilateral debt, implementation of sound economic policies.

South Asia

- Afghan Communist Party last week ended second congress ever . . . Najibullah unanimously reelected chairman of renamed Homeland Party, stressed party unity . . . more cosmetic attempts to increase regime's appeal likely.

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Parallel Effort To Sustain East Bloc Trade

Prague, probably supported by Hungary and Poland, is pressing for the European Bank for Reconstruction and Development (EBRD) to loan Moscow \$16 billion tied to Soviet purchases of Czechoslovak, Polish, and Hungarian industrial and consumer goods. Moscow would receive \$5 billion annually over three years; the remaining \$1 billion would finance Soviet investment projects being developed with the East Europeans. The credits would be repayable in rubles over 10 years.

Without a guaranteed market, many Czechoslovak heavy industries will lose out to Western suppliers when Moscow begins conducting all international trade on a hard currency basis in January. The West Europeans almost certainly are aware of the potential for instability if East European trade patterns are disrupted; more than 2 million people in the three countries work in the most vulnerable sectors, machine building and metallurgy. Although they want to circumvent the EBRD ceiling on lending to the USSR, the West Europeans would balk at concentrating most of the Bank's resources in three countries.

The Soviets will resist tying funds to purchases from Eastern Europe. They would prefer loans to buy Western machinery and equipment. Moreover, Moscow expects energy exports to Eastern Europe to earn enough to pay for what it needs from that region once world market prices are imposed.

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Special Analysis

USSR: Seeking Western Economic Aid

At the Houston summit, the West Germans and the French will press the case for economic aid to the USSR, but Moscow's economic problems require far more than the three-year, \$20 billion package it reportedly has requested. Unless it is subject to economic and political conditions, a sizable Western aid package would be wasted and might even slow reforms.

Many West Europeans governments, particularly Bonn and Paris with help from Rome, believe the West must act quickly to help the Soviets through a difficult transitional phase in their reform program. Although welcoming a US initiative on technical aid, most West Europeans believe the Soviet situation also requires significant financial help. West German attitudes, in particular, have been shaped by pessimistic reports on the Soviet economy, and officials increasingly believe Soviet economic problems may cause President Gorbachev's ouster. Bonn also has a political agenda and is looking to Western aid to help ease unification.

Moscow's Motives

Soviet leaders are seeking economic aid because they believe some type of formal Western economic package will help them placate workers during the implementation of painful economic reforms. The USSR's deteriorating international financial position is making it harder to finance enough imports of consumer goods without the help of Western governments. Western banks are reducing their exposure and raising interest rates on loans to the USSR.

Moscow also believes it can extract economic payoffs from the West now for the changing directions in Soviet domestic and foreign policies. The leadership may think the West is likely to be especially responsive because of fears Gorbachev will lose power. Moscow may hope to entice formal US participation by holding out the likelihood of substantial sales for US firms.

Tangible Needs Far Greater

The specific needs of Soviet consumers and industry total much more than it has requested:

- Spread over three years, \$20 billion would make only minor contributions to satisfying Soviet needs if divided among foodstuffs, industrial consumer goods, machinery and equipment, and technical expertise.

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- Even if spent exclusively for consumers, it would give morale an important boost but make only a small dent in the excess purchasing power of consumers and add only a little to annual retail sales.

Virtually every segment of Soviet society has been engaged in dialogue with Western experts on how to transform the economy. But the sluggish pace of meaningful reforms and the bungling of some programs, such as price reforms, indicate how little the Soviets have learned.

Moscow Can Use Only So Much

Moscow's serious structural, political, and societal obstacles would dilute the impact of most assistance other than technical expertise:

- More imports financed by the West could clog storage and delivery systems and add to already serious supply disruptions; wide-scale corruption and black-marketeering further diminish the system's capability to get goods to their destinations.
- The Soviets have long had major difficulties assimilating imported equipment, and purchases worth billions of rubles reportedly are already lying idle in warehouses and fields.
- Moscow cannot take on more debt, even on concessional terms, especially if the credits are used largely for consumer goods and do nothing to enhance export potential.

Conditionality and Soviet Reactions

Unless the aid is tied to economic and political conditions, the Soviet leadership may be able to use it to postpone meaningful reforms and effectively subsidize the military. Moreover, a package given solely to authorities in Moscow might help recentralize authority by letting them dictate terms before doling out assistance to more independent, reform-minded republics or cities. Although Gorbachev will argue it will be hard politically for him to accept conditions, he is likely to deal as long as he is seen to be exerting a reasonable measure of control over the package. He will be particularly amenable to conditions that coincide with his view of reforms or that enhance his objective of increasing Soviet participation in the world economy. Gorbachev will be much more receptive to conditions that operate through such multilateral institutions as the IMF, the EC, and the OECD.

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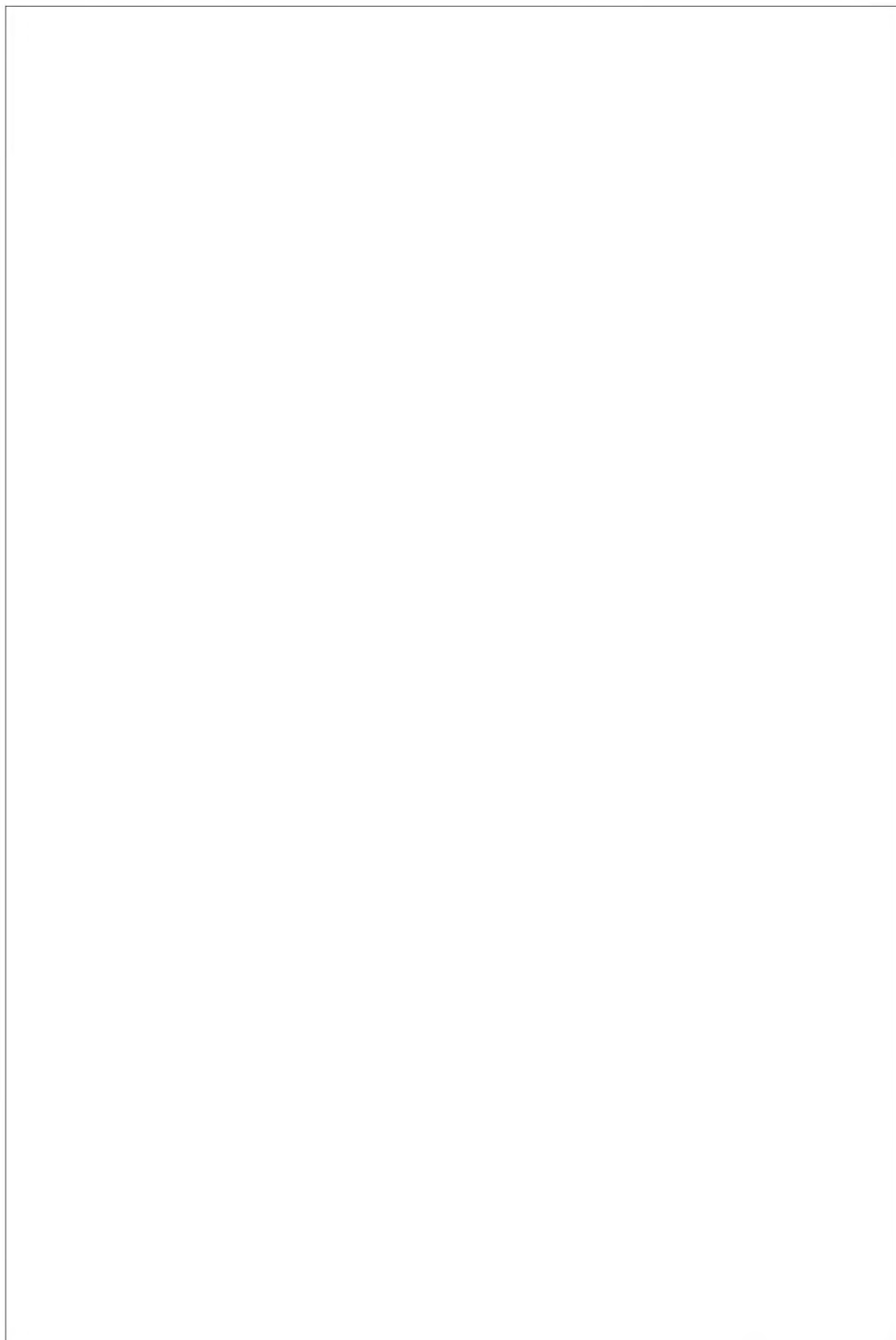
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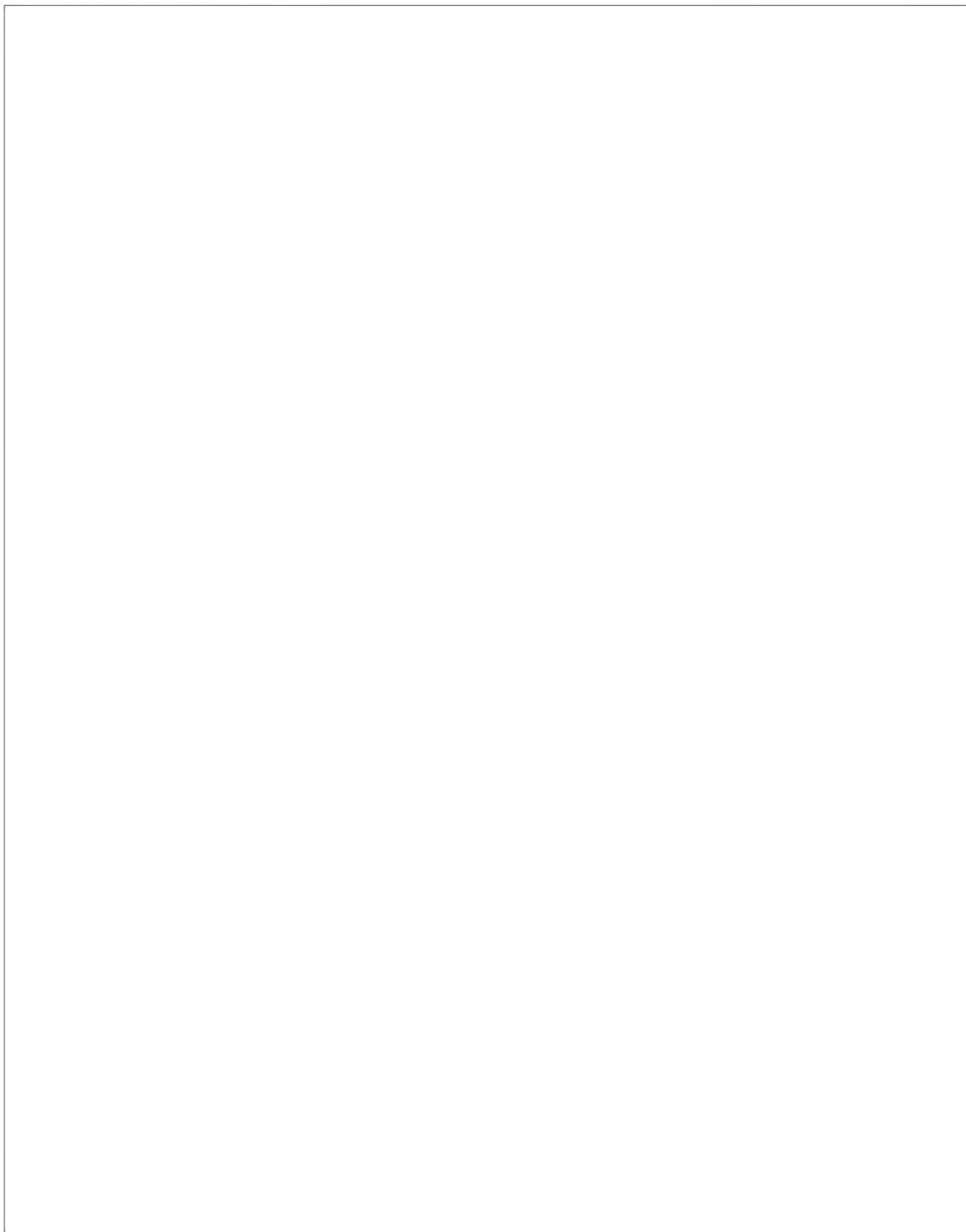
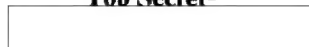


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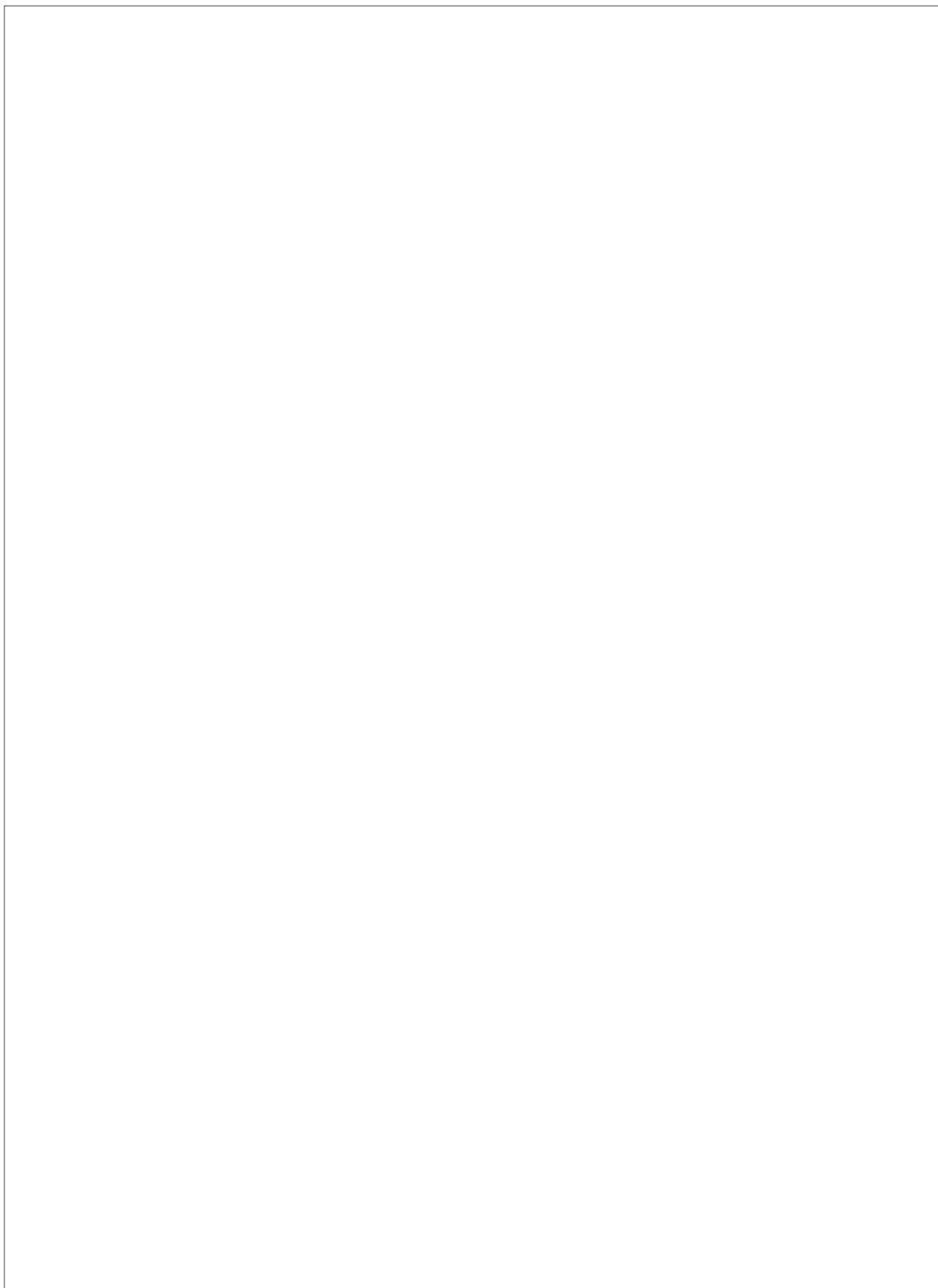


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